February 9, 2009

Ms. Wendy M. Payne
Federal Accounting Standards Advisory Board
441 G Street, NW
Suite 6814
Washington, D.C. 20548

Dear Ms. Payne:

Thank you for the opportunity to provide input on the *Accounting for Social Insurance, Revised* exposure draft. The content and presentation of financial estimates related to the future financial status of social insurance programs is critical to both the public understanding and the understanding of policymakers who will be deciding on what changes are needed in these programs.

We believe that the most fundamental issue is that the disclosures appropriately reflect the nature of the programs and their intended financing mechanisms, and that these disclosures are presented in a way that is as straightforward and unambiguous as possible. For this reason, it is surprising that this exposure draft suggests making a closed group perspective the predominant mode of presentation for programs that are financed on a current-cost or pay-as-you-go basis. Such closed group presentations, whether closed to new entrants or closed to new contributions (as in the accrued benefit obligation), are inappropriate and highly misleading as measures of financial status for social insurance programs. Our collective objective must be to inform the public and policymakers with the most appropriate representation of the expected future financial status of these programs. Only then can we have assurance that changes made in the future will appropriately address the needs of the American people.

This exposure draft includes some very useful additions, such as the inclusion in the financial statements a presentation of the basis for changes from the prior valuation. But, like the basic valuation itself, this must be done on an open group basis consistent with the financing mechanism in the law for these programs. In general, we find the perspective of Mr. Werfel in this exposure draft captures well the appropriate approach for these disclosures. We look forward to the further opportunity to discuss these issues with you and the Board. Please contact Karen Glenn or me at 410-965-3000 if you have any questions regarding our comments.

Sincerely,

Stephen C. Goss

Stephen C. Goss
Chief Actuary

Name: Stephen C. Goss, Karen P. Glenn

Title/Organization (if applicable): Chief Actuary, Social Security Administration,
Actuary, Social Security Administration

Contact information: Stephen.C.Goss@ssa.gov, Karen.P.Glenn@ssa.gov

Date: February 9, 2009

Comments on FASAB Exposure Draft: *Accounting for Social Insurance, Revised*, dated November 17, 2008

Responses to Questions for Respondents:

Q1. The Board proposes to require social insurance component entities and the governmentwide entity to discuss and analyze key measures from the basic financial statements in their management's discussion and analysis ("MD&A"). See paragraphs 26–30 in the proposed standard and paragraphs A75—A79 in the basis for conclusions.

Do you believe that key measures should be presented in the MD&A as described in this exposure draft?

Please provide the rationale for your answers.

We agree that social insurance component entities and the governmentwide entity should discuss "critical measures" from their basic statements in the MD&A. However, the selection of measures deemed to be "critical" should not be prescribed by this standard. The decision regarding which measures are "critical" and require discussion in the MD&A should be left to the preparer.

In particular, mandating presentation and/or discussion of the closed group measure for social insurance commitments would be highly inappropriate as this measure is extremely misleading in the context of any program that is financed on a current-cost basis. If anything, presentation and discussion of closed group measures should be discouraged by the standard. Our objection to the closed group measure is described more fully in response to Question 2 below.

As noted in paragraph 27, the measure of "fiscal gap" is discussed extensively in the exposure draft *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government* (*"Projections* ED"). Discussion of fiscal gap or other sustainability measures in the MD&A should be left to the discretion of the governmentwide entity. Because fiscal gap, and any measure that summarizes financial flows over a long period of time in a single number, cannot address sustainability of financing, measures that illustrate timing and trend of any projected future financial costs or shortfalls should be encouraged over summary measures.

Q2. The Board is proposing to add a line for the **closed group measure** to the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications.[1] See paragraphs 31—32 in the proposed standard and paragraphs A81—A100 in the basis for conclusions. Two members have submitted alternative views on this issue. See paragraphs A139—A142 in the basis for conclusions for Mr. Patton's view. Mr. Patton and other members believe that a liability greater than the due and payable amount should be recognized on the balance sheet. See paragraph A144 in the basis for conclusions for Mr. Werfel's view. Mr. Werfel and other members believe that the closed group measure should not be presented on the balance sheet.

Do you believe that the balance sheet should present a line item for the closed group measure as described in this exposure draft?

Please provide the rationale for your answers.

No, the balance sheet should not present a line item for the closed group measure. This would be inappropriate and misleading. We agree with the alternative view put forth by Mr. Werfel in paragraph A144.

The balance sheet, which by definition presents assets and liabilities at a single point in time, is not the appropriate place to display social insurance commitments or obligations on either an open group or a closed group basis. Future social insurance obligations are not liabilities, and should not be presented on the balance sheet as such, whether above the line, or "below-the-line" as proposed.

However, our objection to the inclusion of the closed group measure is even more fundamental. The closed group measure represents an estimate of the excess of the obligation for current-law scheduled *future* benefits for current participants over current-law scheduled *future* taxes from only those current participants. The closed group measure is not at all relevant to the financial status of programs financed on a current-cost basis. Closed group measures should not be presented on the balance sheet or elsewhere in the financial statements for Social Security, Medicare, or government discretionary spending programs, all of which are financed on a current-cost basis. Doing so would be very misleading and would encourage a fundamental misunderstanding of the financing basis for the programs. Any program with future obligations that are intended to be and will be financed on a current-cost basis as obligations come due will have a substantial closed group shortfall, even when financing is expected to be perfectly adequate on a current-cost basis. Any inclusion of a closed group measure in financial reporting for a program with current-cost financing should be strongly discouraged by the FASAB rather than encouraged.

While the closed group measure is presented in the Social Security Trustees Report, it is displayed along with the net present value for future participants, solely as an illustrative decomposition of the open group measure. The decomposition represents a

[1] Definitions of certain terms are provided in the Definitions section and Appendix F: Glossary of this proposed standard.

generational perspective that may be of interest from a relatively academic analytical perspective, but it has no relevance at all to the financial status of a current-cost-financed or pay-as-you-go system. The closed group measure is also currently included in the SOSI, where it is described and explained in more detail in the supporting disclosures. Rather than encouraging or prescribing further presentation of this misleading measure, the FASAB should encourage further disclosure and emphasis on measures that illustrate the timing and trend in annual government obligations and cash-flow balances that are critical to an understanding of sustainability of the various government programs. Summary measures that are misleading and distracting should be discouraged rather than encouraged by the FASAB.

Some have argued that more measures and illustrations are necessarily better. This is an appealing concept, but it is false. Readers of any document, including the governmentwide entity financial statements, have limited time and attention that can be devoted to that particular document. It is the obligation of the preparers, and of standard-setting bodies like the FASAB, to make such statements as straightforward as possible with great emphasis on the information that will convey a true sense of the status of the programs in question. Inclusion of closed group measures is highly undesirable in achieving this end.

Q3. The Board proposes to add a new summary section of the statement of social insurance ("SOSI") to present the closed and open group measures. See paragraphs 34—35 in the proposed standard and paragraphs A114—A116 in the basis for conclusions.

Do you believe that the SOSI should have a summary section as described in this exposure draft?

Please provide the rationale for your answers.

The current presentation in the SOSI shows, and emphasizes, the open group future income and costs for these programs, with a decomposition of total income and total cost into generational components that allow the computation of a closed group measure for the interested reader. Explicit presentation of the closed group measure in the SOSI would be counterproductive and misleading. In particular, the net of expected future obligations and taxes for specific generational components should not be presented as indicated in pro-forma SOSI in Appendix D. In summary, the SOSI presentation should not be altered as suggested by paragraphs 33-35. If any change were to be made to the SOSI, it should be to include the amount of any financial assets held by the specific program in a trust fund at the beginning of the valuation period. Inclusion of such assets would transform the "bottom line" of the SOSI into the "unfunded obligation" for the program, which would have far greater meaning and relevance to the financial status of the program.

Q4. The Board proposes a new basic financial statement entitled "statement of changes in social insurance amounts." The new statement would explain the changes during the reporting period in the present value amounts for the closed

Do you believe there should be a new basic financial statement explaining changes to the present value amount included in SOSI?

Please provide the rationale for your answers.

Again, we agree in principle with the alternative view put forth by Mr. Werfel. The new statement of changes in social insurance amounts should focus solely on the open group measure and not on the closed group measure. As described above, the closed group measure is highly misleading for programs financed on a current-cost basis, and so its presentation should be discouraged. However, the proposed statement of changes, properly focused on the open group measure in SOSI, is appropriate and valuable.

The proposed new statement as illustrated in Appendix E is good, but should be altered in two ways. First, as stated above, the new statement should address the open group measure only and should not address the closed group measure. Addressing the closed group measure solely would be highly misleading, and addressing both the open group and closed group measures here would be confusing, as well as misleading

Second, the new statement illustrated in Appendix E should include a separate line item for "change in valuation period" as the initial change. This entry would show the extent of the change in present value purely due to the change in valuation date. These changes include (1) the change in the date to which annual estimates are discounted, which alone increases the magnitude of the measured amount by the nominal annual rate of interest, (2) the omission of obligations and taxes for the first year of the former valuation period, and (3) the net obligations over taxes for the last year of the new valuation period. Inclusion of these items in "Other changes" after the other line items would be inappropriate, as these changes due to the change in the valuation date are fundamental and occur even if there is no change for any of the other reasons. The other categories of change are logical, informative, and readily available, as they coincide with values already computed and provided in the annual Trustees Reports for Social Security and Medicare. The presentations of change in these reports have been developed and refined for decades. The table illustrating changes in the open group measure would be a useful addition to the required supplementary information in the financial statements.

Q5. The Board proposes to disclose an accrued benefit obligation in notes to the financial statements. This information would include a five year trend when the standard is fully implemented. See paragraph 38 in the proposed standard and paragraphs A117—A123 in the basis for conclusions. Mr. Werfel and other members have an alternative view expressing opposition to this disclosure. See paragraph A146 in the basis for conclusions.

Do you believe that an accrued benefit obligation should be disclosed as described in this exposure draft?

Please provide the rationale for your answers.

We agree with the position of Mr. Werfel as stated in paragraph A146. It is not appropriate to present the accrued benefit obligation in the notes to the financial statements. Social insurance programs are appropriately characterized as statements of intent for future benefits of a general nature, but do not make commitments to any level of benefits that may be scheduled in current law. The historical record makes this clear. Projected shortfalls in expected financing for social insurance programs should only be presented on a basis that properly accounts for the intended financing of the program. For a current-cost-financed program like Social Security, only the open group measure is appropriate. The closed group measure, and the even more specific "accrued benefit obligation," are inappropriate and misleading and do not contribute to the understanding of the financial challenges presented by the program.

The accrued benefit obligation is a measure of the future benefit obligation based on past earnings and past work in covered employment as of the valuation date. The accrued benefit obligation is simply not a meaningful number for an ongoing pay-as-you-go social insurance program that is subject to certain change in the future. Moreover, the difficulty in defining the basis for computation of this measure is enormous. While such values have been estimated on a rough basis for illustrative purposes by the Social Security actuaries, the complexity of assumptions needed would make this measure highly controversial if there were any attempt to portray it as a meaningful indicator of financial status. If the program were converting abruptly to a new form that applies not only for future participants but also with respect to all future taxes or premiums of current participants, then the accrued benefit obligation might be of some interest, as a "transition cost" component for the total net cost of conversion to the new form. This is the context in which this value is computed and presented in publications by the Social Security actuaries. However, this measure is inappropriate for inclusion in the financial statement for ongoing programs like Social Security.

In addition, as stated by Mr. Werfel, the presentation of yet another measure of social insurance commitments would likely confuse and mislead users of the financial statements.

Q6. The Board considered but decided not to propose adding a line item to the statement of net cost ("SNC") for the change during the reporting period in the closed group measure that would be presented below exchange revenue and expenses and not included in the totals for these classifications. Some argue that this measure should not be presented on the SNC because it is a fundamentally different measure. Others believe the change is an economic cost that belongs on the SNC, and that including this number at the bottom of the SNC appropriately links all basic financial statements. See paragraphs A101—A113 in the basis for conclusions.

Do you believe that the SNC should not include a line item for the change during the period in the closed group measure, which would be presented below exchange revenue and expenses and not included in the totals for these classifications?

Please provide the rationale for your answers.

We agree that the SNC should not include a line item for the change during the period in the closed group measure. Moreover, the SNC should not include a line item for even the change in the open group net obligation for social insurance programs. We agree with the members of the Board who believe that a measure representing future obligations which are not current costs should not be presented on the SNC because it is a fundamentally different measure. The SNC is just that: a statement of net cost for a particular year. It should reflect the principle of matching costs of government operations during a particular year with services provided by the government during that year. Displaying the change in a measure which includes future scheduled benefits would not match this principle, even if presented "below-the-line."

Once again, we stress our objections to employing the closed group measure at all, in accordance with the alternative view presented by Mr. Werfel.

Q7. The Board decided to present the closed group measure (CGM) (defined in paragraph 19) as a common thread among the proposed new reporting. The proposal requires that the CGM and other key measures from the financial statements be discussed in management's discussion and analysis; that the CGM be presented on the balance sheet below assets, liabilities and net position (without being included in the totals for those categories); and that the changes in the CGM during the reporting period be presented and explained in the new summary section of the statement of social insurance and the new statement of changes in social insurance. The Board considered the open group measure (defined in paragraph 24) instead of the closed group measure as the focus for the disclosure. This exposure draft discusses both the closed group measure and the open group measure throughout. Paragraphs A69-A74 provide the basic rationale for the Board's selection of the closed group measure. Mr. Werfel and other members have an alternative view regarding the presentation of the closed group measure. They oppose the addition of the closed group measure to the balance sheet. Further, they believe the open group measure is the appropriate measure to use in the new statement of changes in social insurance and not the closed group measure. See paragraph A145 in the basis for conclusions.

Do you agree with the Board's decision to feature the closed group measure?

Please provide the rationale for your answers.

We do not agree with the Board's decision to feature the closed group measure. We are in agreement with Mr. Werfel's view that the open group measure is the appropriate measure to use in the new statement of changes in social insurance. We also agree with Mr. Werfel that the closed group measure should not be added to the balance sheet.

The closed group measure reflects only current program beneficiaries and participants and assumes that the program is closed to future participants, which is entirely inconsistent with the design of the program and its basic financing principle (i.e. that the program will be financed essentially on a pay-as-you-go basis).

The open group measure appropriately reflects the pay-as-you-go nature of the program: taxes from future participants will be used to pay for benefits to current participants. It measures the extent to which future scheduled taxes will be sufficient to pay future scheduled benefits on the actual basis by which the program is actually financed. Shifting emphasis of the financial statements for social insurance by either the component entities or the governmentwide entity to a closed group approach would be highly misleading for readers of the statements. The FASAB should, in fact, strongly discourage presentation of closed group measures rather than encouraging or prescribing their use.

In addition, the basis for any assessment or measurement of social insurance sustainability must be done on an open group basis. The Social Security and Medicare Trustees Reports follow this principle with emphasis almost exclusively on the open group; the closed group is only presented as an illustrative component of the theoretical decomposition of the open group from a generational perspective. This kind of academic analysis has no relevance in a financial statement. Focusing on the closed group measure would inappropriately magnify the difference between projected obligations and projected taxes and would be misleading and confusing for readers of the financial statements.

Q8. The Board is proposing to change the requirement currently in SFFAS 17 for specific sensitivity analysis. The standard will require the entity to provide sensitivity analysis of the closed and open group measures appropriate for its particular social insurance program but will not specify a particular approach for the analysis. See paragraphs 42—43 of the standard and paragraphs A125—A137 of the basis for conclusions.

Do you believe that a general requirement that allows flexibility in the sensitivity analysis presented will produce better information regarding the sensitivity of social insurance programs?

Please offer any comments that you wish to make on these provisions.

We agree that flexibility in the sensitivity analysis requirement is desirable and can produce better information for users. Streamlining the information presented, while retaining the most relevant and meaningful portions of the analysis, will lead to a more concise and less overwhelming presentation. But sensitivity analysis, per se, should continue to include estimates of the effects of changes in individual assumptions, as is currently the case. The statement in Paragraph 42 suggesting that sensitivity analysis might illustrate the effects if "…data, methodologies, and other inputs are changed" is unclear.

Including the results of stochastic modeling, as suggested in paragraph 43, is a useful consideration in displaying the distribution and uncertainty of future outcomes. But this presentation of uncertainty is fundamentally different from sensitivity analysis for specific possible changes in specific assumptions. Mention of the possible inclusion of stochastic analysis for social insurance programs in the financial statements should be made in the context of discussion of uncertainty, and not in the context of sensitivity analysis. The Social Security Trustees Report has presented stochastic estimates since 2003 as a supplement to the traditional methods of analyzing uncertainty. However, care should be taken in emphasizing stochastic analysis, as the science is still under development and current estimates are incomplete. It is understood that current presentations of stochastic ranges of potential outcomes understate the size of this range of potential outcomes at a given level of probability. Thus, for now, stochastic projections should be excluded from the financial statements. Inclusion of such analysis, with appropriate caveats, would introduce considerable additional detail and complexity, thus reducing the clarity and emphasis of the statements on the critical measures.

Also note that sensitivity analysis should be required and presented in the financial statements only on an open group basis. For all the reasons stated above, closed group measures are inappropriate and misleading, and would create a distraction that would be confusing and diminish the opportunity to present meaningful information in the financial statements.